Decision ________________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Roseville Telephone Company (U 1015 C) to Review Its New Regulatory Framework.	Application 99-03-025 (Filed March 8, 1999)

DECISION DENYING PETITION TO MODIFY DECISION 01-06-077

I. Summary

On May 3, 2002, Roseville Telephone Company (Roseville) filed a petition to modify Decision (D.) 01-06-077. In D.01-06-077, we reviewed Roseville's new regulatory framework (NRF) structure, and addressed a variety of issues raised by an audit of Roseville's affiliate and non-regulated operations conducted by the Commission's Office of Ratepayer Advocates (ORA). In the petition, Roseville asks the Commission to eliminate the requirement to share 50% of its earnings between the benchmark rate of return and the ceiling rate of return. By this decision, we deny the petition because Roseville has provided nothing that convinces us that change is needed at this time. In addition, we order Roseville to file for its next NRF review 90 days after a final decision in Rulemaking (R.) 01-09-001 and Investigation (I.) 01-09-002, the NRF review for Pacific Bell Telephone Company, now SBC California, and Verizon California Incorporated.

II. Roseville's Petition

Under Roseville's current NRF, there is no sharing below the benchmark rate of return (11.5%). There is 50% sharing between the benchmark rate of return and the ceiling rate of return (15%), and 100% sharing above the ceiling rate of return.[1] Under Roseville's proposal, there would be no sharing below the ceiling rate of return, and 100% sharing above it.

Roseville represents that, due to increased competition, it has lost over 13% of its business access lines to competitors. It also says it has lost 11% of its residential customers to wireless competitors. In addition, it says that its growth in access lines has declined to one percent per year rather than the six to eight percent of previous years. As a result, Roseville says that it is essential that all telecommunications providers be subject to non-discriminatory and economically correct investment incentives. Roseville represents that sharing (i) dilutes incentives to invest in new infrastructure and technology, (ii) distorts pricing decisions for regulated services, (iii) does nothing to mitigate theoretical incentives to misallocate costs and subsidize competitive services, and (iv) continues to impose regulatory costs and inefficiencies. Roseville further contends that the current sharing mechanism will discourage investment in non-regulated plant that will provide new services to customers.

In support of its argument, Roseville says that its board of directors decided not to consider funding for projects involving non-regulated wireless and video services that would have utilized Roseville's network.[2] In addition, its board of directors reduced Roseville's 2002 capital budget by $10 million. However, Roseville maintains that it continues to make the investments necessary to maintain service to its customers.

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[1] The percent sharing refers to the amount of earnings returned to ratepayers. For example, 50% sharing means that 50% of the earnings are returned to ratepayers.

[2] Roseville is owned by SureWest Communications, a holding company.

III. Discussion

In its petition, Roseville utilizes some of the arguments made in its original application wherein it requested complete elimination of sharing.[3] The only new information it provides in the petition is that it believes competition has increased, and its board of directors has reduced its capital budget.[4] We have actively encouraged competition, and NRF was designed with competition in mind. Therefore, we believe that the competition alleged by Roseville is desirable and not, in and of itself, justification for removing the 50% sharing requirement.

Roseville has not made a convincing argument that its reduced capital spending on regulated services is directly attributable to sharing. Sharing applies only to some of the regulated services Roseville provides. Roseville has not shown what portion of its reduced capital spending for regulated operations was for services subject to sharing. To the extent that some portion of the reduction was for such services, Roseville has not demonstrated that sharing was the primary reason for the reduction, or what role other factors, such as the effect of capital markets or economic conditions may have had. To the extent that some portion of the reduction was for regulated services not subject to sharing,

[3] In its comments on the draft decision, Roseville states that only two options were considered in the original proceeding regarding sharing; elimination, or complete retention of sharing. This is because, while Roseville could have proposed other options, it chose not to do so.

[4] ORA filed a response in opposition to the petition. If the Commission were to consider granting the petition, hearings would be necessary to allow parties to address contested issues of fact raised by the new information on which Roseville bases its petition.

Roseville has not demonstrated that sharing was the primary reason for reduced capital spending on those services, or what role other factors, such as the effect of capital markets or economic conditions may have had.

Roseville argues that investments in non-regulated services increase earnings for services subject to sharing because: (1) such services typically utilize regulated services from Roseville, and (2) joint and common costs are spread over a greater base resulting in a lower allocation to regulated operations. Presumably, Roseville makes investments in non-regulated services in order to make a profit on those services. Roseville has not said that this is not the case. Such profits are not subject to sharing. It is possible that non-regulated operations may improve the earnings of regulated operations, some portion of which are subject to sharing. However, Roseville has not demonstrated that any of the actual investments it decided not to make in non-regulated operations would have resulted in any significant actual effect on shared earnings, or that the sharing of such earnings was sufficient to warrant the reduction in the investments. Roseville also has not shown what role other factors, such as the effect of capital markets or economic conditions may have had. As a result, it is simply not credible that Roseville would base its decisions on investments in unregulated operations primarily on whether they would result in sharing of earnings for regulated services subject to sharing.

A major factor in retaining sharing was the fact that Roseville had misallocated costs in a way that cross-subsidized its unregulated affiliates. The Commission determined that continuation of sharing, combined with effective auditing, could serve as an important means of preventing shareholders from benefiting from cross-subsidization. While Roseville argues that sharing does not diminish the theoretical incentive to cross-subsidize unregulated services, it did not attempt to demonstrate what it has done to eliminate the type of cross-subsidization we previously found. As a result, we have no reason to believe that cross-subsidization should not still be a concern.

Reinstatement of sharing is an issue before us in R.01-09-001 and I.01-09-002. Therefore, it makes sense to address Roseville's NRF, including its concerns regarding sharing, after those proceedings have been completed. As a result, we will direct Roseville to file for its next NRF review no later than 90 days after a final decision therein. If, in the future, the Commission determines that it is appropriate for Roseville to file for its next NRF review at an earlier date, it will issue a decision to that effect.

IV. Comments on Draft Decision

The draft decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by Roseville and ORA. All comments were considered, and changes have been made where appropriate.

V. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Jeffrey P. O'Donnell is the assigned ALJ in this proceeding.

Findings of Fact

1. The increased competition, alleged by Roseville, is desirable and not, in and of itself, justification for removing sharing.

2. Sharing applies only to some of the regulated services Roseville provides.

3. Roseville has not shown what portion of its reduced capital spending for regulated operations was for services subject to sharing.

4. To the extent that some portion of the reduced capital spending was for regulated services subject to sharing, Roseville has not demonstrated that sharing was the primary reason, or what role other factors, such as the effect of capital markets or economic conditions, may have had.

5. Roseville has not shown what portion of its reduced capital spending for regulated operations was for services not subject to sharing.

6. To the extent that some portion of the reduced capital spending was for regulated services not subject to sharing, Roseville has not demonstrated that sharing was the primary reason, or what role other factors, such as the effect of capital markets or economic conditions, may have had.

7. It is reasonable to presume that Roseville makes investments in non-regulated services in order to make a profit on those services, and Roseville has not said that this is not the case.

8. Profits from non-regulated operations are not subject to sharing.

9. Roseville has not demonstrated that any of the actual investments it decided not to make in non-regulated operations would have resulted in any significant actual effect on shared earnings, that the sharing of such earnings was sufficient to warrant the reduction in the investments, or what role other factors, such as the effect of capital markets or economic conditions may have had.

10. It is not credible that Roseville would base its decisions on investments in unregulated operations primarily on whether they would result in sharing of earnings for regulated services subject to sharing.

11. In D.01-06-077, a major factor in the Commission's decision to retain sharing was the fact Roseville had misallocated costs in a way that cross-subsidized its unregulated affiliates.

12. In D.01-06-077, the Commission determined that continuation of sharing, combined with effective auditing, could serve as an important means of preventing shareholders from benefiting from cross-subsidization.

13. Roseville did not demonstrate what it has done to eliminate the type of cross-subsidization we previously found.

14. It makes sense to address Roseville's NRF after R.01-09-001 and I.01-09-002 have been completed.

Conclusions of Law

1. Roseville has provided nothing that convinces us to change D.01-06-077.

2. The Commission has no reason to believe that cross-subsidization should not still be a concern.

3. Roseville's petition to modify D.01-06-077 should be denied.

4. Roseville should be directed to file for its next NRF review no later than 90 days after a final decision in R.01-09-001 and I.01-09-002.

O R D E R

IT IS ORDERED that:

1. The petition of Roseville Telephone Company (Roseville) to modify Decision 01-06-077 is denied.

2. Roseville shall file its next review of its New Regulatory Framework after, but in no case more than 90 days after, a final decision in Rulemaking 01-09-001 and Investigation 01-09-002, or as specified in a further order of the Commission.

This proceeding is closed.

This order is effective today.

Dated______________, at San Francisco, California.